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HAROLD B. WILLEY,

IN THE

Supreme Court of the United States

OCTOBER TERM, 1952.

No. 566

CARTER H. HARRISON, INDIVIDUALLY AND AS COLLECTOR OF INTERNAL REVENUE,
Petitioner,

vs.

EDWIN J. BOHNEN, EXECUTOR OF THE ESTATE OF MARY A. BOHNEN, AND INDIVIDUALLY; THEODORE G. BOHNEN AND VIRGINIA E. BOHNEN,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR THE RESPONDENTS.

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OPINIONS BELOW.

The opinion of the District Court (R. 33-38) is reported at 100 F. Supp. 118. The opinion (R. 55-57) and dissenting opinion (R. 58-59) of the Court of Appeals are reported at 199 F. 2d 492.

JURISDICTION.

The judgment of the Court of Appeals was entered on October 29, 1952. (R. 60.) The petition for a writ of certiorari was filed on January 26, 1953, and was granted on March 9, 1953. (R. 63.) The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

STATUTE.

The applicable provisions of the statute involved are set forth in the Appendix hereto. The statute is set forth in the same form used in petitioner's brief, *i. e.*, as amended in 1949, in order to obviate confusion in reference. The language is precisely the same as that in effect at the time of the death of decedent in 1942, although somewhat rearranged.

SUMMARY OF ARGUMENT

Decedent purchased a life insurance contract and an annuity contract. The life contract would not have been sold without the annuity contract. She then made an absolute gift of the life insurance contract to her children, retaining no interest in it. If it be assumed that both contracts were acquired in a single integrated transaction, they were nevertheless divisible and were in fact completely severed by the decedent, just as shares of stock might have been acquired in a single transaction and subsequently severed by a gift of part and a retention of the balance. Decedent reserved no interest of any kind, reversionary or otherwise, in either the life insurance contract or the income therefrom.

The present situation involves no possible aspect of tax avoidance, and falls within neither the letter nor spirit of Section 811 (c)(1)(B). Decedent retained the annuity contract which she could have purchased without the life insurance contract. (Instead of purchasing the life insurance contract, she could have made a cash gift to the donees of the amount of the premium.) The retained interest situations subject to Section 811 (c)(1)(B) always involve an arrangement in which the donee's interest is diminished for the advantage of the decedent. Here, if anything, the converse was true. The purchase of the annuity contract was a condition to the procuring of the life insurance contract for decedent's children. Moreover, such benefits as were conferred on the children were complete and irrevocable at the time of purchase, and nothing further passed from decedent to the donees at death, either in fact or in theory.

Helvering v. *LeGierse*, 312 U. S. 531 (1931), is inapplicable to the instant case. In that case decedent retained full ownership of both policies until death. The case merely held that the issuance of the two contracts in a single transaction obviated the "insurance risk" which would otherwise have been present. In *Goldstone* v. *United States*, 325 U. S. 687 (1945), the Supreme Court specifically declined to extend the *LeGierse* case to the instant situation.

The instant case involves no question of an insurance exemption in view of the present condition of the Code; hence the nature of the property originally acquired by decedent, or whether acquired in one or two transactions, is utterly immaterial. Nevertheless, petitioner devotes virtually his entire brief to this false issue and ignores the determinative fact of what decedent did with the property she had acquired.

The annuity payments were not the income from the life insurance premium, but rather comprised of income and principal of the annuity premium. The income from the life insurance premium consisted of the dividends on that policy and the increase in value of that policy from 65.8% to 100% of face value. (R. 25.) Both of these items of income were irrevocably assigned to respondents with the contract and collected by them.

Respondents were entitled to surrender the life insurance policy at any time after one year from date of issuance, and receive amounts ranging upward from $47,376. (R. 25.) Despite such surrender decedent would have continued to receive the annuity payments. Income is the fruit which grows upon the tree of principal. Fruit which continues to grow after a tree is cut must grow upon some other tree. The tree upon which the annuity payments grew was not the life insurance premium, but the annuity

premium, and the payments constituted in part a liquidation of the latter tree itself.

Respondents concede that petitioner's position is sustained by the cases of *Estate of Reynolds* v. *Commissioner*, 45 B. T. A. 44 (1941), *Burr* v. *Commissioner*, 156 F. 2d 871 (C. C. A. 2, 1946), and *Conway* v. *Glenn*, 193 F. 2d 965 (C. A. 6, 1952), but contend that these cases were erroneously decided and should be repudiated by the court. They are erroneous for the following reasons:

1. They misconceive the holding in the *LeGierse* case.
2. They confine attention to the nature and character of the property and treat the transfer as of no significance.
3. They misconceive the holdings in *Commissioner* v. *Clise*, 122 F. 2d 998 (C. A. 9, 1941) and *Commissioner* v. *Wilder's Estate*, 118 F. 2d 281 (C. A. 5, 1941).
4. They confuse the several clauses of Section 811 (c) and disregard the purpose underlying the imposition of the estate tax on *inter vivos* transfers.
5. They err in concluding that the annuity payments constituted income from the combined premiums.

The results reached by the courts below could be independently arrived at by conceding the petitioner's contentions on all other points and applying the apportionment provisions of Section 81.18 of the Estate Tax Regulations, 105.

the premium allocated to the life policy. This would certainly not have been tax avoidance. To no greater extent do the facts of the instant case constitute tax avoidance.

The real and only issue in this case is whether or not decedent did in fact make a transfer of property and retain the income from that property during her lifetime. Even more specifically stated, the issue is: Were the annuity payments the "income" from the life policy transferred to respondents? The Court of Appeals below aptly said (R. 57):

> "It is contended that the annuity payments constituted income from the life policy. It would seem that to state the proposition is to demonstrate its fallacy. The annuities were bought and paid for in the annuity contract, when the insured paid in $22,000. None of this came out of the life insurance premium. The life policy was fully paid for by the $53,000 advanced for it; no part of it contributed in any way to the annuities. If the assignees had cashed the life policy, as they had a right to do, the insured would have still been entitled to receive the annuities. The assignees were in truth, not by any fiction the absolute owners of the life policy, whereas the decedent kept for herself the annuity contract."

In his argument petitioner nowhere actually addresses himself to the real issue, beyond stating the conclusion that the annuity payments constituted the income from the life policy, and asking the court to assume this ultimate issue upon the authority of decisions cited. (B. 12 and 13.) Certain of these decisions support petitioner's contention; the others are inapplicable. *Estate of Reynolds* v. *Commissioner*, 45 B. T. A. 44 (1941); *Burr* v. *Commissioner*, 156 F. 2d 871 (C. A. 2d, 1946), certiorari denied, 329 U. S. 785; and *Conway* v. *Glenn*, 193 F. 2d 965 (C. A. 6th, 1952), cited

in the order of decision, do support petitioner's position.[2] These cases are substantially identical factually with the case at bar. Respondents conceded this at the time they filed their motion for summary judgment in the district court. They did not attempt to distinguish these cases then and they do not do so now.[3] It is respondents' position that these cases were erroneously decided and should be repudiated by this court. Necessarily, a major portion of this brief is devoted, as were the briefs in the courts below, to an analysis of these cases, and particularly of the *Burr* case.

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2. Petitioner also cites (B. 12) *Bank of New York* v. *Kelly*, 135 N. J. Eq. 418 (1944), involving a somewhat similar issue arising under a state succession tax. That case follows the reasoning and authority of *Estate of Reynolds* v. *Commissioner*, 45 B. T. A. 44 (1941).

3. It would seem that the doctrine of these cases as well as certain originally erroneous doctrines of the common law, has arisen from the tendency prevalent among lawyers to attempt to distinguish upon a basis of comparatively insignificant facts cases erroneously decided, rather than challenging the basis for the erroneous decision. This has apparently occurred in connection with the present problem. The factual situation of all three cases was substantially the same (as is that of the instant case), except that in the *Reynolds* case the life insurance policies were transferred irrevocably to a trustee rather than to the ultimate beneficiaries, and except that the transfers there were made in conjunction with certain other revocable trust transfers, which doubtless influenced the Board of Tax Appeals and lent some semblance of color to the Commissioner's contention. In the *Burr* case, counsel for the taxpayer, rather than assailing the soundness of the *Reynolds* decision, apparently attempted to distinguish that case on the facts. In the *Burr* case, the Court refers to the *Reynolds* case as follows:

> "In that case, too, the assignment was irrevocable; and it is not to be distinguished, as petitioners claim, because it was to a trustee. The interposition of the trustee was of no significance; he had power to assign and to surrender the policy, and was required to distribute all dividends to the beneficiaries. The case was noted with approval in 42 Col. L. Rev. 162." [156 F. 2d 871, 872.]

In *Conway* v. *Glenn*, 193 F. 2d 965, taxpayer's counsel sought to distinguish the *Burr* case upon a basis of the following facts stated in the opinion of the Court of Appeals (p. 966):

> "After this transfer was made by the decedent and during

The other cases cited by petitioner are wholly inapplicable and lend his position no support. These cases fall into three categories, typified respectively by the following cases:

Igleheart v. *Commissioner*, 174 F. 2d 605 (C. A. 7th, 1949).

Commissioner v. *Clise*, 122 F. 2d 998 (C. A. 9th, 1941).

Helvering v. *LeGierse*, 312 U. S. 531.

For the most part, these cases are examined and distinguished at length later in this brief. In none of these cases did the beneficiary receive anything susceptible of enjoyment during the lifetime of the decedent, and in each of these cases the beneficiary was required to survive the decedent to receive any benefit. The *Igleheart* case involved a straight investment contract, with stipulated payments of income, and principal payable on demand or on death.

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his lifetime, the owners of the life insurance policy on two occasions exercised rights under the contract: (1) they named their mother as beneficiary to receive fixed monthly payments from the proceeds of the policy on the death of their father; and later (2) they changed the beneficiary interest in the policy so that their mother would receive only the interest income on the face amount of the policy."

The following extract from page 12 of Appellant's Brief in *Conway* v. *Glenn* indicates the argument made:

"The government contends that the instant case is on all fours with the *Burr* case, *supra*. A very important distinction can be made, however. In the *Burr* case, *supra*, the sons exercised none of their rights of ownership during their father's lifetime. In the case at bar, the children, who are the sole owners of the life policy, exercised their unrestricted rights of ownership by assigning to their mother, if she should survive the decedent, the entire income from the policy for her life (R. 23, 24). They thereby diminished their interest in the property."

Upon payment of principal, income ceased.[4] The *Clise* case involved joint and survivor annuity contracts in each of which decedent had named herself as primary annuitant, and some other person as a second annuitant to receive the annuity after her death, and until the second annuitant's death. In neither the *Igleheart* nor *Clise* cases was it possible to withdraw any principal sum from the insurance company and still have the stipulated payments continue to any party. In both cases the payments did in fact consist of income from the total premiums invested.

The only question determined by the Supreme Court in the *LeGierse* case was that in the case of annuity and life insurance policies, such as those here under consideration, the policies should be treated as a single investment contract, the risks of which neutralize one another, and that therefore, the life insurance contract did not constitute

4. The case involved the question of whether or not the payments were taxable for income tax purposes as annuity payments under Section 22 (b)(2). The Court held that they were not and that such payments were income in their entirety. The pertinent facts are stated by the Court as follows (174 F. 2d 605):

> "Prior to the taxable year 1941 taxpayer had purchased nine insurance contracts from three insurance companies, each providing for the payment of a fixed principal sum to the taxpayer upon his surrender of the contract (or to designated beneficiaries upon his death) and for annual payments to him in the interim. Each contract was issued in consideration of a single premium. A medical examination was not a prerequisite for any of the contracts. The premiums paid by taxpayer were not computed with reference to his age or tables of mortality, but in each contract the premium was equal to the principal sum of the contract plus an additional 5%, except for two contracts for which he paid an additional 6%. The premium for each contract was the same as charged any applicant for a similar policy regardless of age and sex.
>
> "Except for a small percentage charge, the principal sum of each contract corresponds with the single premium paid therefor. Upon surrender of the contract at any time, the principal sum thereof is payable to taxpayer. No matter how many annual payments he may have received, he is still entitled, on demand, to have the principal sum returned to him intact."

"insurance" within the purview of Section 302 (g)[5] so as to entitle the estate to the $40,000 deduction for insurance therein provided, a deduction subsequently eliminated from the Code. There was no other question pending before the Court, and no other question was decided by the Court. In the *LeGierse* case both contracts with the insurance company remained the property of the decedent at his death; hence, there could be no possible question as to "includibility" in the gross estate. The question was solely one of a deduction, which could not possibly arise unless includibility were assumed or conceded. It is true that the Court said that the deficiency in the *LeGierse* case had been properly assessed, but simply because the deduction claimed by the taxpayer could not be allowed.

Petitioner takes the position, as did the courts in *Estate of Reynolds* v. *Commissioner*, 45 B.T.A. 44 (1941); *Burr* v. *Commissioner*, 156 F. 2d 871 (C. A. 2d, 1946) certiorari denied, 329 U. S. 785; and *Conway* v. *Glenn*, 193 F. 2d 965 (C. A. 6th, 1952), that the *LeGierse* case is dispositive of the present issue. This assumption is one in which the Supreme Court itself has specifically declined to concur. *Goldstone* v. *United States*, 325 U. S. 687, 693 (1945).

In the *Goldstone* case the decedent had purchased a single premium life insurance policy and an annuity contract under the arrangement common to most of the cases herein referred to. The life policy designated his wife, his daughters, or his estate as beneficiaries, in the order named. Both policies gave the decedent's wife the unrestricted

5. Prior to amendment in 1942, Sec. 811 (g), formerly 302 (g) read as follows:

"(g) Proceeds of Life Insurance.—To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life."

power to assign them, borrow money, receive dividends, change beneficiaries, and surrender the contract and obtain the surrender value thereof. Provision was made that if the wife predeceased the decedent, then the rights of ownership should vest in the decedent to the extent that such powers had not otherwise been exercised by the wife. At the time of decedent's death, he was survived by his wife and daughters, and the wife had not surrendered, assigned, or otherwise alienated either of the contracts.

Two questions were presented in the case: One as to whether or not the taxpayer was entitled to the specific "insurance" exemption provided in Section 302 (g), and the second, whether or not the proceeds of the life insurance policy were includible in the gross estate. The court cited and relied upon the *LeGierse* case, solely for the purpose of ruling against the taxpayer with reference to the applicability of the insurance exemption provisions of Section 302 (g). With reference to the second question, *i. e.*, whether or not the proceeds of the life policy should be includible in the gross estate, the court made no reference whatever to the *LeGierse* case, but predicated includibility squarely upon *Helvering* v. *Hallock*, 309 U. S. 106 (1940),[6] that the decedent retained "a contingent reversionary interest in the entire proceeds of both contracts."

Attention is particularly invited to the fact that the government urged upon the court the argument relied upon in the instant case, and subsequently approved by the Second Circuit Court of Appeals in the *Burr* case, and that the

6. Decedent had transferred property into trust, giving the income to his wife for life, and providing that upon her death the corpus should be delivered to decedent, or, if he were not alive, to his children. The court held that the retention of the reversionary interest by the decedent rendered the property includible under § 302 (c), now § 811 (c) as having passed by a transfer "intended to take effect in possession or enjoyment at or after his death."

court specifically declined to pass upon that argument. The court used the following language (325 U. S. 687, 693):

> "In our view of the case we need not consider the alternative argument urged by the United States to the effect that the specific amendments to §302 (c) are also applicable since the decedent actually received an annual return from the contracts for a period which did not in fact end before his death."

It should be remembered that the opinion in the *Goldstone* case was written by Mr. Justice Murphy, who wrote the opinion in the *LeGierse* case. Had it been the intention of the court in the *LeGierse* case to lay down as broad a doctrine as that contended for by the government, and approved in the *Burr* case, certainly no one would have been better aware of that intention than Mr. Justice Murphy. Yet in the *Goldstone* case, the Court, speaking through Mr. Justice Murphy, declined to adopt any such doctrine. This was in 1945, four years after the *Reynolds* case, and only a year before the *Burr* case.

II.

THE CONTENTION OF PETITIONER ATTACHES UNDUE SIGNIFICANCE TO THE CHARACTER OF THE PROPERTY AND THE RELATIONSHIP OF DECEDENT TO THE INSURANCE COMPANY, AND IGNORES THE PARAMOUNT CONSIDERATION OF THE CHARACTER OF THE TRANSACTION WHICH WAS MADE WITH REFERENCE TO THE PROPERTY AND THE LEGAL EFFECTS THEREOF.

As suggested at the outset, petitioner has devoted by far the major portion of its argument to consideration of the nature of the contractual relations between decedent and the insurance company, and apparently attaches so much importance to this consideration that he tends to treat as of no significance the actual transaction upon

which the assertion of the tax is predicated, *i. e.*, the transfer.[7] The question of taxability must be determined on a basis of the following provision of the statute:

> "To the extent of any interest therein of which the decedent has at any time made a transfer * * * under which he has retained for his life * * * (i) the possession or enjoyment of, or the right to the income from, the property * * *." (I. R. C., Section 811 (c) (1)(B).)

Immediately after stating his position, petitioner addresses himself to what he apparently believes to be the crux of the argument:

> "1. In determining the applicability of Code Section 811 (c)(1)(B) to the circumstances of this case, the initial and crucial inquiry must focus on the essential nature of the transaction between the decedent and the insurance company."

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7. Thus petitioner brushes aside as not material or of no significance—

(1) The fact that assignees of the life policy could have surrendered it at any time (Pet. Br. 5);

(2) The fact that they were entitled to receive dividends on the life policy (Pet. Br. 5);

(3) The distinction between the instant situation wherein the life insurance could be surrendered without affecting the annuity payments and several situations in which continued receipt of annuity payments is dependent upon keeping the life insurance contract in effect. These other situations are set out both in the text and the footnote both hypothetically and by citation of cited cases with utter disregard of the significance of the "transfer" made in the instant case (Pet. Br. 13-14).

Petitioner apparently follows the technique of the court in the *Burr* case, discussed in detail later in this brief, which technique is epitomized in the following language from the *Burr* opinion (156 F. 2d 871):

> "The two purchases were obviously a single transaction, the annuity premium being part of the consideration for the insurance policies. Unless differentiated because of the subsequent assignment, therefore, the case is squarely within the Supreme Court's decision in *Helvering* v. *LeGierse*, 312 U. S. 531, 61 S. Ct. 646, 85 L. Ed. 996, holding the proceeds of the policies taxable under § 811 (c)."

It is submitted that petitioner has wholly misconceived the issue. The statute refers to property and interests in property, without particularly defining or limiting them, obviously intending the category to be all embracing. The statute makes no distinction as to what the type of property is, and it is submitted that the nature and character of the property is immaterial. The pertinent inquiry is: What did the decedent do with the property?

Respondents' position is that the decedent acquired certain property (and for the purpose of Section 811 (c)(1)(B) it makes no difference whether the property was or was not insurance, or by what name or designation it is described); that she gave away part of this property and kept part of it; and that she retained no interest in the part she gave away.

Respondents submit that it is immaterial whether the property originally acquired constituted one parcel of property or several, or whether it was acquired in one transaction or several, inasmuch as the property was certainly of a type which was susceptible of division, whatever its original character with reference to unity or integration may have been.

If a father desires to buy a quarter section of land from a neighboring farmer for the purpose of making a gift of it to his son, and he is unable to buy the quarter section without buying a complete half section of which it is a part, and he buys the half section and then gives the quarter section to his son without any strings attached and keeps the other quarter until his death, and farms and enjoys it and derives the income therefrom, it certainly cannot be contended that the quarter section given *inter vivos* to his son is includible in the estate at death by reason of the facts stated. If, on the other hand, the decedent, having purchased the half section, should then decide that he will

reserve unto himself a life interest in the entire half section, and should give only the remainder interest to his son, then obviously the entire half section is includible in decedent's estate at death under Section 811 (c)(1)(B).

Although in both instances the property was undoubtedly an integrated unit when purchased and was acquired in a single transaction, that matter is of no significance to the determination of the present question. It might become quite pertinent with reference to the allocation of cost basis for purposes of determining capital gains. The thing that is significant in determining applicability of Section 811 (c)(1)(B) is the character of the interest subsequently given and the character of the interest, if any, reserved.

The same considerations apply to an almost unlimited range of property and transactions, in which a person who desires to buy one item of property is required by the wishes of the seller to buy another item of property in an integrated transaction, and subsequently makes a complete unrestricted *inter vivos* gift of the item which he desired to buy, and retains the other item which he was required to buy. A homely example would arise in a situation where a man desires to buy a pony for his son from the owner who will not sell the pony, unless he can also sell the buggy used with it. The man buys the pony and buggy, makes an unrestricted gift of the pony to his son, and retains the buggy and makes such use of it as he can until his death. Certainly the petitioner would not contend that the value of the pony should be included in the decedent's estate.

Respondents will not unduly multiply examples, but offer merely one further situation which they deem closely analogous to the situation at bar.

A hypothetical corporation is willing to sell any amount of its preferred stock, but will only sell its common stock

to a purchaser who, at the same time, buys a specified amount of its preferred stock. (The analogy of the preferred and common stock to the annuity and life insurance policies respectively, is, of course, obvious.) A buyer enters into an agreement for the purchase of the required amount of preferred stock in order to obtain the common stock. He immediately thereafter makes an absolute, irrevocable, and immediate gift of the common stock to his son, including the entire income therefrom, but retains the preferred stock. Can it be seriously contended that because the donor, in order to secure the common stock, was required to purchase at the same time a given amount of preferred stock, he has, for that reason, retained an income for life in both the common and preferred stock so as to render the common stock includible and taxable in his gross estate at death? It is, of course, true that in determining and allocating the basis of the stock for purposes of capital gain, the Commissioner would have the right to treat the purchase as one entire contract, even after the transfer to the son, since his would be a substituted basis.

The analogy of the hypothetical situation to the instant case is apparent. In both the *LeGierse* case and in the case of the hypothetical situation, the court treats several transactions as an entire contract for a particular purpose, *i. e.*, in the *LeGierse* case, for the purpose of determining eligibility for the insurance deduction under 302 (g), and in the hypothetical situation, for determining the basis of the stock. However, it is not a necessary concomitant of this proposition that the two contracts must always continue to be one for every and all purposes, and that they cannot be severed by assignment of one of the contracts, as was done in the instant case. If the logic of the *Burr* case and of petitioner's contention, were applied to the hypothetical situation, the value of the common stock would be included in the gross estate.

III.

THE COURT OF APPEALS BELOW CORRECTLY HELD THAT THE ANNUITY PAYMENTS RECEIVED BY THE DECEDENT DID NOT CONSTITUTE INCOME FROM THE LIFE POLICY.

The Court below correctly rejected petitioner's contention that the annuity payments constituted income from the life policy, with the observation "that to state the proposition is to demonstrate its fallacy." (R. 57.) Petitioner's contention disregards the nature and character of the term "income" when that term is used as it is in the pertinent statute in conjunction with "property." In law and in general acceptance, the income from property is the money or property which grows from, is paid for the use of, or otherwise accrues from the property to which it is appurtenant. Profits or income constitute an integral part of the property itself. They are a fruit which grow upon the tree of property, and cease to grow when the tree dies or is destroyed. No concept is more firmly rooted in our law and tradition. *Pollack* v. *Farmer's Loan and Trust Co.*, 157 U. S. 429 (1895).[8] The Supreme Court has defined

8. In holding invalid certain provisions of an 1894 statute imposing an income tax, the court in the *Pollack* case gave exhaustive consideration to the nature of income from property and the relationship thereof to the property from which it was derived. Although the court divided on certain ultimate issues, no dissent was expressed from the proposition that the income from property is an integral part of the property itself. Typical of the many authorities to this effect, quoted with approval, are the following:

Coke upon Littleton: "If a man seized of lands in fee by his deed granteth to another the profit of those lands, to have and to hold to him and his heires, and maketh livery *secundum formam chartae*, the whole land itselfe, doth passe; for what is the land but the profits thereof?" Lib. 1, cap. 1, § 1, p. 4b. (157 U. S. 429, 580, 590.)

Jarman on Wills, Vol. 1, page 740: "* * * a devise of the rents and profits or of the income of land passes the land itself both at law and in equity; a rule, it is said, founded on the feudal law, according to which the whole beneficial interest in the land consisted in the right to take the rents and profits." (157 U. S. 429, 580, 589.)

income as "the gain derived from capital, from labor, or from both combined." *Eisner* v. *Macomber*, 252 U. S. 189 (1920). If there could be any doubt that the term "income" as used in Section 811 (c)(1)(B) contemplates and requires the continued existence of the property to which the income is applicable, such doubt would be immediately dispelled by the other language of the pertinent phrase, *i. e.*, "* * * the possession or enjoyment of, or the right to the income from, the property * * *."

Income in the sense here pertinent, is money received from the use of money or property. If Smith buys corporate stock, he receives income in the form of dividends so long as he holds the stock, but no longer. If Black lends money to White, he receives income in the form of interest so long as White has the use of his money, but no longer. If Smith sells his stock he ceases to receive income therefrom. When Black receives payment of his money, he stops getting interest. But, in the instant case, if the assignees of the life insurance contract had surrendered their contract a year after it was written and received the money invested, decedent would still have been entitled to receive her annuity payments right up to the day of her death. It would follow that the annuity payments did not constitute "income on the money invested in the life insurance contract."[9]

Petitioner's contention is predicated upon the unfounded assumption that the annuity income constitutes the sole income from the total premiums invested in both the life

9. Had they, however, surrendered the life insurance policy, assignees would have ceased to receive the dividends on that contract, and it would have ceased to appreciate in value. These are the elements of income on the life insurance policy, and they were received by and accrued to the benefit of assignees, and not to the decedent.

and annuity contracts. It is not. Actually there are four elements of income:

1. The annuity payments.
2. Dividends on the annuity contract.
3. The dividends on the life policy.
4. The increment in value of the life policy.[10]

Of these four elements of income, the first two were to be received and were received by the decedent; the last two were irrevocably assigned to the respondents and actually received by them.[11]

Actually the annuity payments constituted income only in part, and were comprised principally of repayments of capital. The insurance company required the purchase of the annuity contract as a condition to issuing the life insurance contract without examination. The converse is not true. The company, or any insurance company, would have been glad to issue the annuity contract alone without purchase of the life insurance contract. Physical examination is not required for the purchase of annuity policies, for the obvious reason that physical infirmity of the annuitant renders the contract more attractive to the company. The annuity contract was of the non-refundable type, *i. e.*, no guaranteed aggregate sum was to be paid, and all rights under the contract were to terminate at death no matter how soon that might have occurred. (R. 12, 13.) Hence, the theory of the policy is that part of each

10. This item of income rather than being paid periodically, accrues, after the nature of the accruals of income upon government E bonds, purchased at 75% of face value and redeemable upon demand at some percentage of face value between 75% and 100%, depending upon the time held. The policy itself sets forth the table of increasing surrender values (R. 25), in form, appearance, and computation not too dissimilar from the table appearing on the reverse side of government E bonds, and indicates the basis of computation of the income by way of accrual.

11. The dividends on the life policy were by the respondents reassigned to Virginia E. Bohnen, one of the respondents (R. 16).

payment represents refund of premium and the balance interest thereon, or income.

This is the theory upon which annuity payments are taxed for income tax purposes. Under Section 22 (b) (2) of the Code, annuity payments are treated as income to the extent of three per cent of the consideration or aggregate premiums, and the balance of the payments in excess of that amount are treated as return of capital or investment, until all capital has been recovered. The annuitant in the instant case lived less than seven years after purchase of the contract, and accordingly received only six annual payments. (R. 3, 12.) The allocation under Section 22 (b) (2) is as follows:

Date	Annuity Payments	Allocation		Principal Still to Be Received
	Amount	To Income*	Return of Principal	
				$22,602.96
Oct. 15, 1936....	$1,618.03	$ 678.09	$ 939.94	21,663.02
Oct. 15, 1937....	1,618.03	678.09	939.94	20,723.08
Oct. 15, 1938....	1,618.03	678.09	939.94	19,783.14
Oct. 15, 1939....	1,618.03	678.09	939.94	18,843.20
Oct. 15, 1940....	1,618.03	678.09	939.94	17,903.26
Oct. 15, 1941....	1,618.03	678.09	939.94	16,963.32**
	$9,708.18	$4,068.54	$5,639.64	

* 3% of Premium, *i. e.*, $22,602.96.

** Never recovered, except for such dividends as may have been received on the annuity policy. The record does not indicate the amount of such dividends; hence they cannot be used in the computation.

If petitioner were correct in his contention that the annuity payments constituted income on the total premiums paid for both policies, then under Section 22 (b) (2) three per cent of such total premiums should be treated as income. The Commissioner has asserted this theory in the courts, but without success.[12]

12. *Koehrer* v. *Commissioner*, C. C. H. Dec. 14,408 (M) (Tax Court Memorandum Decision, 1945), relying in part upon *Helvering* v. *Meredith*, 140 F. 2d 973 (C. C. A. 8, 1944). These cases are discussed in Section IV (5) of this brief.

The unsoundness of petitioner's contention that the annuity payments constituted income on both contracts may be tested by a further consideration. The total premiums paid amounted to $76,320, *i. e.*, $53,717.04 on the life policy, and $22,602.96 on the annuity contract. Total sums received from the company were $81,708.18, *i. e.*, $72,000 face value of the life policy and $9,708.18, total annuity payments. Hence total receipts exceeded total investment by $5,388.18. This would, upon petitioner's theory, constitute total "income" on the investment, and yet decedent received aggregate annuity payments of $9,708.18. It is thus clear that the annuity payments were not restricted to "income." Hence, they must have consisted of "income" and "principal." Since the annuity contract was and would have been issued independently of the life policy, and was so computed actuarily, it is clear that the annuity payments constituted income and principal on the annuity contract above.[13]

IV.

THE CASE OF BURR v. COMMISSIONER, 156 F. 2d 871, WAS ERRONEOUSLY DECIDED, AS WERE ESTATE OF REYNOLDS v. COMMISSIONER, 45 B. T. A. 44, WHICH PRECEDED IT, AND CONWAY v. GLENN, 139 F. 2d 965, WHICH FOLLOWED IT.

It should be noted at the outset that the Court of Appeals for the Second Circuit, with two of the same judges participating who decided the *Burr* case, has recently rendered a decision which casts grave doubt on the reasoning of the *Burr* case. In *Commissioner* v. *Twogood's Estate*,

13. It is true that dividends were paid both on the annuity contract and on the life policy, the former to decedent, the latter to the assignees and owners of the life policy. Such dividends were, however, independent of the actuarial computations. Anyway, the dividends on the life policy would obviously exceed those on the annuity policy because of the higher premium reserve, and face value of the life policy (R. 14, 15, 23, 25).

194 F. 2d 627 (C. A. 2d, 1952), the decedent had been the beneficiary of a company retirement plan under which he could, and did, elect to reduce the annual payments to be received by him in order to provide for the payment of an annuity to his wife after his death. The Commissioner added to the value of the decendant's gross estate an amount equal to the value at the decendent's death of the annuity payable to his wife. In the Court of Appeals the Commissioner's sole contention was that the value of the annuity payable to the decedent's wife was includible in his gross estate on the theory that he had made a transfer of property under which he retained for his life the possession or enjoyment of, or the right to, the income from the property. The Court rejected the Commissioner's contention, and held that no life interest was retained by the decedent in what his wife received by his election under the plan. The Court said that to meet the requirements for includibility in the decedent's estate under Section 811 (c)(1)(B) "there must be some causal relationship between the property transferred and the payments received by the transferor * * *." (194 F. 2d at 629.) It is difficult to understand how the same court which failed to find such a causal relationship in the *Twogood* case, could have believed that there was one in the *Burr* case.

It is submitted that the erroneous decision reached in the *Burr* case (and in the other two cases cited) resulted from the following principal errors and misconceptions:

(1) The Court misconceived the holding and scope of *Helvering* v. *LeGierse*, 312 U. S. 531, and subordinated substance to form.

(2) The Court focused attention upon the relationship between the decedent and a third party, *i. e.*, the insurance company, to the exclusion of the determinative and significant relationship between the decedent and the transferee.

(3) The Court misconceived the factual situation of, holdings in, and significance of *Commissioner* v. *Clise*, 122 F. 2d 998 (C. A. 9, 1941) and *Commissioner* v. *Wilder's Estate*, 118 F. 2d 281 (C. A. 5, 1941).

(4) The Court ignored the distinction between transfers "intended to take effect in possession at or after his death" and "transfers under which he has retained for his life * * * the possession or enjoyment of or the right to the income from the property," and disregarded also the theory and purpose of imposing an estate tax upon *inter vivos* transfers.

(5) The Court erred in concluding that the annuity payments constituted the income from the combined premiums.

(1) In Burr v. Commissioner, 156 F. 2d 871, the Court Misconceived the Holding and Scope of Helvering v. LeGierse, 312 U. S. 531, and Subordinated Substance to Form.

In the *LeGierse* case the decedent had purchased both an annuity and life insurance policy on her own life, naming her daughter as beneficiary. Decedent was eighty years old at the time, and the life insurance policy would not have been issued, but for the purchase of the annuity contract. All rights of ownership, in both the annuity contract and the life insurance policy, were retained by the decedent until the time of her death.

The court held that the life insurance policy did not constitute insurance within the purview of Section 302 (g)[14] so as to entitle the estate to the $40,000 deduction

14. Prior to amendment in 1942, Sec. 811 (g), formerly 302 (g) read as follows:

"(g) Proceeds of Life Insurance.—To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life."

for insurance therein provided; and that the proceeds of the insurance policy were "taxable under Section 302 (c) of the Revenue Act of 1926 as amended as a transfer to take effect in possession or enjoyment at or after death."

In the *Burr* case the essential factual situation was the same as in the *LeGierse* case, except that the decedent, subsequent to purchase thereof, assigned ownership of the life policies (here there were several policies) to his sons. The Second Circuit Court of Appeals held that upon the death of the decedent, the proceeds of the insurance policies transferred *inter vivos* constituted "transferring a remainder while retaining a life interest—or in the terms of the statute—retaining the enjoyment or the right to the income from the property."

The court's position in the *Burr* case would seem to be that in the *LeGierse* case, the Supreme Court has laid down the broad proposition that in any annuity-single premium life insurance policy situation where decedent has paid the premiums, the proceeds of the life policy are *ipso facto* includible in decedent's estate, irrespective of what decedent may have done subsequently with the life policy. The following language is pertinent (p. 871):

> "The two purchases were obviously a single transaction, the annuity premium being part of the consideration for the insurance policies. Unless differentiated because of the subsequent assignment, therefore, the case is squarely within the Supreme Court's decision in *Helvering* v. *LeGierse*, 312 U. S. 531, 61 S. Ct. 646, 85 L. Ed. 996, holding the proceeds of the policies taxable under § 811 (c)."

The *LeGierse* case does not support this proposition at all. In that case, the taxpayer never seriously denied that the proceeds of the life insurance policy were includible in the gross estate "as a transfer to take effect in possession or enjoyment at or after death." Certainly, he

could not seriously have taken such a position in view of the fact that the beneficiary acquired no right, title or interest whatever in the policy or its proceeds until the death of the insured. The only real question before the court was as to whether or not the life insurance policy constituted "insurance" within the purview of Section 302 (g). The Court held only that the two contracts as written and as they remained throughout the life of the decedent (no change in their status having ever been made) constituted one contract, did not involve an "insurance risk," and did not qualify for the special statutory deduction in Section 302 (g). The court itself states the issue of the case at follows (p. 538): "Thus the basic question is whether the amounts received here are amounts 'receivable as insurance' within the meaning of § 302 (g)."

(2) In Burr v. Commissioner, 156 F. 2d 871, the Court Focused Attention Upon the Relationship Between the Decedent and a Third Party, i. e., the Insurance Company, to the Exclusion of the Determinative and Significant Relationship Between the Decedent and the Transferee.

It is believed that the treatment accorded by the court in the *Burr* case to the relationship between the three parties, *i. e.*, the decedent, the transferee, and the insurance company, is deserving of comment and is indicative of a misconception on the part of the court regarding the ultimate problem. The following language from the opinion is deemed pertinent:

> "When the decedent in this case transferred $107,500 to the insurance company, he obtained from it two promises: one to pay him a small rate of return in the form of monthly annuity payments, the other to transfer $100,000 to the named beneficiaries on his death. His annuity payments represented a fixed per-

centage of the total consideration; and the company investment risk was so calculated as never to exceed the expected income from the premiums on the insurance and the annuities. * * *

"Had the sons actually cashed the insurance policies, the contracts would have been separated and the insurance company would then have had to make annuity payments out of income and capital from the annuity premium. See Meisenholder, Taxation of Annuity Contracts under Estate and Inheritance Taxes, 29 Mich. L. Rev. 856, 884; 42 Col. L. Rev. 162, 165. But they chose not to surrender them; and the unexercised power to do so did not change the factual realities of the transaction. While the power was unexercised, the investment was analogous to a simple annuity with principal payable at death, a transfer which—even when irrevocable—is taxable under § 811 (c). *C. I. R.* v. *Wilder's Estate*, 5 Cir., 118 F. 2d 281, certiorari denied *Wilder's Estate* v. *C. I. R.*, 314 U. S. 634, 62 S. Ct. 67, 86 L. Ed. 509." [156 F. 2d 871, 872.]

Apparently the court's attitude is that if the transferees had surrendered the life insurance policy, and collected the cash surrender value, then no sums would have been taxable to or included in the gross estate of the decedent by virtue of the original transfer; this despite the fact that such surrender of the policy would neither have affected the relationship between the decedent and the insurance company, nor that between the decedent and the transferee. The only relationship which possibly could have been affected would have been that between the transferee and the insurance company.

The language of Section 811 (c) upon which the court predicates liability refers to a transfer of property in which the decedent has reserved the income for life. It is extremely difficult to see how a subsequent transaction between the transferee and a third party, the insurance company, after a complete and irrevocable assignment of

the policy to the beneficiary, with no reversionary or other interest of any type reserved to the decedent, can possibly affect the question of whether or not the decedent has reserved income for life.

It must be remembered that the basis for asserted liability is that the annuity payments constitute the "income" upon both policies since the decedent made no further transactions after the irrevocable assignment of the life insurance policy, and did nothing further whatever to change the status of the contracts, or of his rights. It would seem that he either had or had not reserved the income on the life insurance policy at the time the irrevocable assignment was made.

The reason the court has assumed an illogical position on this point is that it has started out with a highly untenable premise. The obviously untenable premise is that the decedent has retained the income from a contract when he has in fact made a complete assignment of that contract without any reservation of rights whatever.

Recalling the court's attention to the hypothetical situation set forth above,[15] it would seem equally logical to hold that the value of the common stock transferred to decedent's son should be included in decedent's gross estate, if his son retained the stock at the time of decedent's death, but otherwise, if the son resold the stock prior to decedent's death. Certainly it is difficult to believe that it was the intention of Congress or of the Supreme Court that taxability should hinge upon such highly artificial and irrelevant considerations.

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15. *I. e.*, the purchase in a single transaction of preferred stock as a condition to purchase of common stock, and subsequent gift of the common stock to decedent's son (Section I of Argument).

(3) In Burr v. Commissioner, 156 F. 2d 871, the Court Misconceived the Factual Situation of, Holdings in, and Significance of Commissioner v. Clise, 122 F. 2d 998 (C. A. 9, 1941) and Commissioner v. Wilder's Estate, 118 F. 2d 231 (C. A. 5, 1941).

In the *Burr* case the court apparently rested its decision upon the authority of the *Clise* and *Wilder's* cases. These cases seem to the respondents to have been correctly decided, but not to support the *Burr* case, because they involve an entirely different problem. In the *Clise* case, two types of problems were presented: one with reference to the purchase of life and annuity policies; the other with reference to joint and survivor annuity contracts.

The first problem involved policies of the type of the instant case, except that in the *Clise* case the annuity and life policies were retained by the decedent throughout her lifetime. The court held on the authority of the *LeGierse* case, that the proceeds of the policies were includible in the gross estate under Section 302 (c) of the Revenue Act of 1926. That portion of the case was substantially identical with the situation of the *LeGierse* case, and certainly the court could have reached no other conclusion. The real controversy in the case dealt with the other policies involved.

In each of sixteen joint and survivor annuity contracts decedent had named herself as primary annuitant, and some other person as a second annuitant to receive the annuity after her death, and until the second annuitant's death. The question with reference to these contracts was simply whether or not their value at the time of decedent's death should be included in her gross estate under Section 302 (c). It is interesting to note that in the determination of this question, the court made no reference whatever to the *LeGierse* case, despite the fact that the court had relied

upon it in connection with the annuity-life policy problem. This is quite significant, indicating as it does a proposition which should be self-evident, *i. e.*, that the *LeGierse* case is applicable only to the question of whether or not a single contract exists with reference to Section 302 (g), and not with reference to the includibility of the proceeds of a policy under Section 302 (c) (now 811 (c).) The court held that the value of the policies at the time of death was includible in the gross estate, and predicated liability squarely upon the joint resolution of March 3, 1931.[16] The following language is particularly pertinent (p. 1003):

> "Unquestionably, Mrs. Clise, the first annuitant, reserved to herself the enjoyment—the economic benefit, of these contracts, during her lifetime. This is true, just as surely as though she had created a trust fund with her property—money, and reserved to herself a certain sum annually, to be paid out of income and corpus, with the remainder over. Mrs. Clise reserved to herself the complete enjoyment of her property, during her lifetime, to the extent she desired to enjoy it, relieved of the worry and cares of management, and guaranteed an estate to the objects of her bounty after her death. It is clear, therefore, that Mrs. Clise retained to herself the economic benefits of her property during her lifetime."

It may be assumed that in the *Clise* case, the rights of the second annuitant were vested, and that the decedent could not have defeated those rights by surrender of the policy, and certainly not by designating another secondary annui-

16. Following the holding in *May* v. *Heiner*, 281 U. S. 238 (1930), and other decisions cited below, holding the existing statute inapplicable to transfers with reserved life interests, the joint resolution of March 3, 1931 added to Section 302 (c) now 811 (c), the following language:

> "including a transfer under which the transferor has retained for his life or any period not ending before his death (1) the possession or enjoyment of, or the income from, the property or (2) the right to designate the persons who shall possess or enjoy the property or the income thereof;"

tant, since the premium was determined by reference to the ages of the two annuitants. However, the situation presented there was clearly one where the decedent had reserved the life income from the very property in question. There not only was only a single contract originally, but there was not and could not have been a division of that contract, or any way in which the policy or any part or share of it could have been surrendered without interfering with or obliterating the life interest and enjoyment of the decedent. Attention is invited to the court's own language (p. 1003):

> "* * * so long as Mrs. Clise lived, it was impossible for the second annuitants to possess or enjoy the economic benefits of the transfer and until Mrs. Clise's death it was not an absolute certainty that any one of the second annuitants would survive her. The death of the first annuitant, then, was the generating event."

This situation truly fits into the intendment of the clauses of Section 811 (c) dealing with a transfer in which the decedent has reserved the income for life. Certainly this is not the situation of the instant case wherein the transferees could have surrendered and realized upon the value of their contract without in any way interfering with the enjoyment of the income of the decedent.

The *Wilder's Estate* case was substantially identical in all particulars with the joint and survivor annuity situation in the *Clise* case. Although the court was somewhat indefinite as to which clause of Section 811 (c) liability should be predicated upon, it seemed to incline toward the clause concerning transfers "in contemplation of, or intended to take effect in possession or enjoyment at or after his death."

(4) In Burr v. Commissioner, 156 F. 2d 871, the Court Ignored the Distinction Between Transfers "Intended to Take Effect in Possession At or After His Death" and "Transfers Under Which He Has Retained for His Life * * * the Possession or Enjoyment of or the Right to the Income from the Property," and Disregarded Also the Theory and Purpose of Imposing an Estate Tax Upon Inter Vivos Transfers.

The court's misconception of the scope and holding of the *LeGierse* case affected its entire approach to the problem. It assumed that it was dealing merely with a minor variation of a situation already adjudicated in the *LeGierse* case, *i. e.*, "unless differentiated because of the subsequent assignment." This is a curious approach when dealing with a statute the gist of which is the assignment, or "transfer," particularly when one recalls that in *LeGierse*, the taxpayer conceded that the proceeds of the insurance policy were includible, and was merely asking for a deduction therefrom under Section 302 (g). In the *Burr* case, the question of includibility was the ultimate problem.

In the *LeGierse* case includibility was concededly predicated upon the theory of a transfer taking effect in possession or enjoyment at death. The clause dealing with *inter vivos* transfers in which an interest is reserved was obviously inapplicable, since in that case no transfer had ever been made.[17]

17. In *Commissioner* v. *Clise*, 122 F. 2d 998, liability was predicated upon the latter clause, *i. e.*, transfer (the irrevocable designation of the second annuitant) with a reservation of income (the annuity payments). In *Commissioner* v. *Wilder's Estate*, 118 F. 2d 281, the court was somewhat undecided, apparently feeling that the facts could be brought under either clause, but inclining toward the former, *i. e.*, a gift to take effect in possession or enjoyment at death. In the *Burr* case, however, the court, although ostensibly following the *LeGierse* case, predicated liability upon a different clause entirely from that applicable to the *LeGierse* case, without any apparent recognition of the fact that it had shifted

It is believed that the failure of the court to recognize the distinctive character of these two types of clauses is indicative of its superficial treatment of the entire problem of includibility. Further evidence of such superficiality is the following observation of the court (156 F. 2d 871, 872):

> "While the power [to surrender the life policy] was unexercised, the investment was analogous to a simple annuity with principal payable at death, a transfer which—even when irrevocable—is taxable under § 811 (c)."

A moment's reflection indicates the fallacy of such a con-

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the statutory basis for its holding and without one word of explanation therefor.

A sharp distinction has been recognized between these two types of clauses by both the Supreme Court and Congress, since the holding in *May* v. *Heiner*, 281 U. S. 238 (1930), that property transferred *inter vivos* with a reserved life estate was not includible as a transfer intended to take effect at death. Subsequent to that decision, the latter clause was introduced by the Joint Resolution of March 3, 1931, and further clarified and expanded under the Revenue Act of 1932. The Joint Resolution added to Section 302 (c), now 811 (c), the following language: "including a transfer under which the transferor has retained for his life or any period not ending before his death (1) the possession or enjoyment of, or the income from, the property or (2) the right to designate the persons who shall possess or enjoy the property or the income thereof; * * *." The language of the Joint Resolution of March 3, 1931 was revised by Section 803 (a) of the Revenue Act of 1932 to read as follows: "or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; * * *."

The added clauses were subsequently held to be prospective only in their operation. *Hassett* v. *Welch*, 303 U. S. 302 (1938). The cycle has now apparently been closed by the decision in *Commissioner* v. *Church's Estate*, 335 U. S. 632 (1949), in which the Supreme Court repudiated *May* v. *Heiner*. For the period between the date of the Joint Resolution of March 3, 1931, and the decision in the *Church* case, however, the separate character and operation of the two clauses was recognized, and it was, of course, within that period that all of the facts of the instant case arose.

clusion in view of the fact that under a "simple annuity", the annuitant is unable to collect the principal from the insurance company and still continue to receive the annuity payments, whereas in the instant situation collection of the cash surrender value of the life policy would not affect the annuity policy in the slightest.

It would seem clear that the dominant purpose of the statutory provisions of 811 (c), as well as those of 811 (d) (dealing with revocable trusts) is to prevent avoidance of the estate tax. *Paul, Federal Estate and Gift Taxation*, § 7.04 and cases cited therein. Under relevant provisions of 811 (c), in order for a transfer to be taxable, the transfer must either be a substitution for a testamentary disposition, or death must bring about a shift in economic interest. *Op. cit.* § 7.05 and authorities cited. The following language of Mr. Justice Frankfurter, used with reference to a state inheritance tax matter, in *Whitney* v. *Tax Commission*, 309 U. S. 530, 538 (1940), is illustrative:

> "In making this diversion ['to the purposes of the community of a portion of the total current of wealth released by death'] the state is not confined to that kind of wealth which was, in colloquial language, 'owned' by a decedent before death, nor even to that over which he had an unrestricted power of testamentary disposition. It is enough that one person acquires economic interests in property through the death of another person, even though such acquisition is in part the automatic consequence of death or related to the decedent merely because of his power to designate to whom and in what proportions among a restricted class the benefits shall fall.
>
> "The books are replete with recognition of these general principles. Thus the full value of property may be taxed as part of a decedent's gross estate even though held by him merely as a tenant by the entirety, *Tyler* v. *United States*, 281 U. S. 497; likewise the full value of property in which the decedent was only a

joint tenant may be taxed in his estate, *United States* v. *Jacobs*, 306 U. S. 363. In neither of these instances was there an exact equation between the 'beneficial interest' owned by the decedent just before his death and that by which the tax was measured. Again, this Court found no difficulty in sustaining a tax on the transfer of property conveyed in trust by a decedent during his life, although he had divested himself of all beneficial interest in the corpus and had only reserved the power to change the beneficiaries excluding, however, himself and his estate from the range of choice. *Porter* v. *Commissioner*, 288 U. S. 436. The attempt to differentiate the tie that binds these cases by treating the *inter vivos* transfers in these decisions as mere substitutions for testamentary dispositions, disregards the emphasis in these cases on the practical effect of death in bringing about a shift in economic interest, and the power of the legislature to fasten on that shift as the occasion for a tax. This broader base is emphasized, for instance, by the fact that in the *Porter* case the decedent had divested himself of all 'beneficial interest' in the trust property prior to the passage of the taxing act by which the trust was included in the value of his gross estate."

It may be said in general that all of the transfers referred to in the relevant provisions of Section 811 (c), except those involving the reservation of a life interest or income, are taxable on the theory of a shifting of economic interest by death.

Transfers made includible because of the reservation of a life interest or income in the decedent, are taxable as a substitute for a testamentary disposition. It becomes quite pertinent to inquire why transfers under this clause are deemed of a testamentary character. It would seem that all such transfers have the following elements in common, *i. e.*, that the transferor desires to place his property in a position where the transferee will have the ownership, possession and enjoyment of the property upon his death, but neverthe-

less wants to continue to have the use of the property during his life. Accordingly, in each instance the transferor has made some special arrangement with reference to the property transferred under which the freedom of the transferee in dealing with the property has for all practical purposes been substantially circumscribed and limited. Thus, for example, although from a technical property point of view, a remainderman can sell real estate which is subject to a reserved life estate, practically there is no market for such real estate at a price even approximating the actual value thereof. In the case of personalty, such arrangement usually takes the form of a trust, and here again even in the absence of a spendthrift provision, although technically the beneficiary can sell and assign his interest, there is practically no market for such interests.[18] These basic elements may be summarized as follows:

(a) Transferee has received irrevocable interest *inter vivos*.

(b) Transferee will come into enjoyment of property after transferor's death.

(c) Transferor will have enjoyment until his death.

(d) Transferee's enjoyment is postponed until death of transferor for the purpose of enabling transferor to retain enjoyment until his death.

18. The absence of a market for such remainder interests is not only a matter of common knowledge, but has been judicially recognized, *e. g.*, *Mechling* v. *Meyers*, 284 Ill. 484 (1918), in which the Illinois Supreme Court gave the Illinois partition statute an admittedly strained construction in order to obviate partition of a remainder interest. The court said (p. 490):

"If the statute is to be construed as giving a right to compel a sale of a remainder after a life estate, where a purchaser cannot know whether he will get possession of his property in his lifetime or not and the interests of other owners will be sacrificed, a speculator may obtain for a trifling consideration the interest of a needy remainder-man, file a bill for partition of property that cannot be partitioned and practically destroy the other interests. Every sentiment of right and justice rebels against a construction of the statute which would permit such a result."

(c) The arrangement or device employed of necessity so entails the property transferred that transferee is precluded from dealing with it for his own benefit, prior to the death of the transferor.

How does the transfer of the insurance policy in the instant suit stand in the light of such tests? It is undisputed that the assignees of the insurance policy had a ready market for their property at any time by the simple device of surrendering the same to the insurance company at a price commensurate with its then value based mathematically upon investment and actuarial principles.

Was the arrangement made for the purpose of enabling transferor to retain benefits during his life? The only possible benefit reserved to the transferor upon the court's theory was the annuity payments which he was to receive upon the annuity contract. While it is true that the life insurance policy would not be sold without the annuity policy, the converse concededly is not true. The insurance company, or any other company, would have been happy to sell the decedent the annuity policy upon the same terms and yielding the same income for the same premium and thereby securing to the decedent the same benefits, without requiring the purchase of life insurance.

If the petitioner contends that the elements which we have cited as being common to all cases falling within this clause of 811 (c) are not present, then it would seem incumbent upon the government to point out to the court cases where the clause has been applied where such elements have not characterized the facts. We are confident that there are no such cases, other than the erroneous cases here complained of dealing with the present situation.

It is true that many arrangements are entered into where the immediate enjoyment of all or a part of the transferred property is withheld from the beneficiary, where these ele-

ments are not present, as in the case of the creation of many trusts in which no life interest or reversionary interest is reserved to the settlor. In these cases, however, the property is entailed for the protection of the beneficiary, and not for that of the transferor, and in such cases the disposition is not deemed testamentary and the property is not includible under 811 (c).

The fact cannot be too strongly emphasized that the transfer in the instant case falls within neither the letter, the spirit, nor the purpose of Section 811 (c). The transfer was of a life insurance policy. No income was reserved from this policy. The only income resulting from this policy were the dividends provided for therein, and the right to the appreciation in the value thereof, the right to receive both of which was specifically assigned with the policy. There was no "shift of economic interest" by reason of or at the death of decedent, since all such interest had passed irrevocably to the transferees at the time the policy was assigned. There was no entailment of this policy in any way for the benefit of the decedent, nor did the decedent have any "string" by way of possibility of reverter or otherwise on this policy.

(5) In Burr v. Commissioner, 156 F. 2d 871, the Court Erred in Concluding That the Annuity Payments Constituted the Income from the Combined Premiums.

In the *Burr* case the court used the following language (p. 872):

> "When the decedent in this case transferred $107,500 to the insurance company, he obtained from it two promises: one to pay him a small rate of return in the form of monthly annuity payments, the other to transfer $100,000 to the named beneficiaries on his death. His annuity payments represented a fixed percentage of the total consideration; and the company's

> investment risk was so calculated as never to exceed the expected income from the premiums on the insurance and the annuities. See *C.I.R.* v. *Keller's Estate, supra*, 3 Cir., 113 F. 2d 833, 834, 836."

Apparently the court concludes that since the "annuity" payments represented a fixed percentage of the total consideration, the total consideration being the premiums for both policies, it necessarily follows that the annuity payments constitute income upon both policies.

This is a curiously illogical conclusion. The annuity payments are all alike, and the amount of the total consideration is necessarily liquidated. Since identical payments must always constitute a "fixed percentage" of any liquidated amount, such mathematical phenomena can hardly be determinative of the instant problem. The annuity payments also constituted a "fixed percentage" of the consideration for the annuity alone, or, for that matter, of the national debt on the day the *Burr* case was decided.

In *Commissioner* v. *Keller's Estate*, 113 F. 2d 833 (1940), cited as authority in the above quotation, the court, having a case identical with the *LeGierse* case made a careful consideration of the underwriting factors underlying life insurance and annuity policies and concluded that the use of the device employed in the *LeGierse* case, and in the instant case, *i. e.*, of the insurance company protecting itself against the hazard of uninsurability by requiring an annuity policy in a specific minimum amount, did convert what would otherwise have been an insurance risk into an investment risk. The court even set forth in an appendix actuarial formulae demonstrating its conclusion. In the *Keller* case, however, there was no such conclusion reached as that reached in the *Burr* case upon the supposed authority of the *Keller* case. The misconception of the *Keller* case by the court in the *Burr* case is part and parcel of

its general misconception of the scope and holding of the *LeGierse* case.

Let us examine briefly the conclusion reached by the court in the *Burr* case, *i. e.*, that the annuity payments constituted income from both policies. Let us assume, as the court does, that the total consideration, *i. e.*, the premiums for both policies constitutes one lump sum. Consonant with the court's major premise based on the *LeGierse* case, the arrangement does not constitute insurance, but "investment." As indicated in Section I of this brief, the income which the insurance company agreed to pay upon this aggregate investment is not limited to the annuity payments, but is made up of three separate elements: (1) The annuity payments, (2) dividends upon the life insurance policy, and (3) proportionate increase in the value of the life insurance policy as the life expectancy is gradually exhausted.[19] In both the *Burr* case and the instant case, it is conceded that the dividends payable on the life insurance policy were covered by the assignment to the beneficiaries and payable to and received by them.

A study of actuarial formulae and principles (even to the extent that they are set out in the appendix referred to in the *Keller* case) will indicate that the income existing in the form of increase in value of the cash surrender value of a life policy is equal to the aggregate amount of the annuity payments. This is precisely the reason that the courts have held that such an arrangement does not constitute insurance but an investment risk.

Of the four types of income payable on the original aggregate consideration, it is obvious that in the *Burr* case and in the instant case, only the first two types, *i. e.*, the annuity payments, and the dividends on the annuity policy

19. Analogous to government "E" bonds, purchased at $75, worth $100 at maturity, and gradually increasing in value during the ten year period preceding maturity.

were retained by the decedent, and that the balance of the income was assigned to and payable to the beneficiaries.

It should be noted also that even the annuity payments received by the decedent consisted only in part of "income" and that the major part of such payments consisted of return of capital. Under the provisions of Section 22 (b)(2) of the Code, the decedent treated only three per cent of the total annuity premium as income, and excluded the balance as return of capital. The annuity premium was $22,602.96. (R. 7, 8). Hence, three per cent of this, or only $678.09, constituted income to the decedent each year under the statute. The annuity payments were $1,618.03. (R. 7, 8.) Hence, the balance of $939.94 constituted return of capital. The premium on the life insurance policy was $53,717.04. (R. 7, 8.) The total premiums for both policies were $76,320. Under the petitioner's theory, the $678.09 income received by the decedent constituted the total income on an investment of $76,320, or a rate of return of less than one per cent. Respondents submit that this constitutes a *reductio ad absurdum* of the petitioner's argument.

A similar analysis may be made of the petitioner's statement (Pet. Br. 4, 5) that the effect of the purchase of a life insurance policy and an annuity policy is "that the decedent invested a sum with the insurance company, consisting of the net amount of the premiums, she became entitled to the income from the investment in the form of annual payments for the period of her life, and her children, to whom she had assigned the life policy, received the principal amount at her death." This statement is simply contrary to fact, for it ignores the fact that if the decedent, the annuitant, should die before recovering through annuity payments the premium paid for the policy, the unpaid balance (the "corpus" of the annuity policy) would not be paid to the beneficiaries of the life insur-

ance policy, but would remain the property of the insurance company. It is thus apparent that, just as the annuitant's income is not based on the premium paid for the life insurance policy, so the amount payable to the beneficiaries of the life insurance policy is not based on the premium paid for the annuity policy.

It may be pertinent at this point to call attention to Section 81.18 of the Estate Tax Regulations, 105, which, referring to and implementing Section 811 (c), provides in pertinent part as follows:

> "If such retention or reservation is of a part only of the use, possession, income, or other enjoyment of the property, then only a corresponding proportion of the value of the property should be included in determining the value of the gross estate."

If it be assumed *arguendo* that the position of the court in the *Burr* case and of the petitioner is correct in other particulars the decision reached by the courts below would have resulted anyway from the application of Section 81.18. (This matter is discussed in detail in the next succeeding section of this brief.)

It should be noted also that under Section 22 (b)(2) of the Internal Revenue Code, the method of computing income tax upon annuity payments is to treat such payments as income to the extent of three per cent of the aggregate premiums, or consideration, and to exclude the balance as return of capital until such time as all capital has been recovered. If the position of the court in the *Burr* case, and of the petitioner in the instant case, is sound, then it would seem to follow that the premiums paid upon both types of policies constitute the "aggregate premiums or consideration paid," with the result that a larger share of the annual payments to the annuitant would be reportable by him as income.

The petitioner seems to have taken this position unsuccessfully in *Kochrer* v. *Commissioner*, C. C. H. Dec. 14,408 (M) (Tax Court Memorandum Decision, 1945), by assessing a deficiency against an annuitant who had reported annuity income in the usual manner and asserting that the full amount of annuity income was reportable. In this case the taxpayer, the annuitant, had purchased two sets of single premium life insurance policies and annuity policies. He paid the following premiums on these policies:

Life Policy	Annuity Policy	Total Premiums
$39,296.50	$13,703.50	$53,000
7,984.70	2,515.30	10,500

During each of the two taxable years involved, the taxpayer received $1,249.80 in income from one policy, and $232.44 from the other, or a total income from these sources of $1,482.24. He reported as income from these sources for each year the sum of $486.56, computed as three per cent of the total annuity premiums of $13,703.50 and $2,515.30. In assessing a deficiency, the government included the total sum of $1,482.24 in the taxpayer's income for each year. Although the basis for the government's action was not made clear, it would seem to have been that the annuity income was reportable in full because it was less than $1,905.00, which is three per cent of $63,500, the total life insurance and annuity premiums. The court upheld the taxpayer, relying in part on *Helvering* v. *Meredith*, 140 F. 2d 973 (C. C. A. 8, 1944) which affirmed the decision of the Tax Court in *Meredith* v. *Commissioner*, C. C. H. Dec. 13,097 (M) (Tax Court Memorandum Decision, 1943). In the *Meredith* case the government had asserted that single premium life insurance policies and annuity contracts, when purchased together, constitute a single investment for the purpose of taxing as ordinary income to the in-

sured both the total annual payments to her from the annuity contract and the dividends paid to her on the life insurance policies. The court held that the transaction constituted the purchase of two separate contracts, the annuity payments being taxed according to the usual rule, and the dividends on the life policies being non-taxable until they exceed the aggregate premiums paid thereon.

It is submitted that the observations in this subparagraph set forth demonstrate further that the position reached in the *Burr* case and asserted by the petitioner in the instant case, is not only a sharp deviation from the applicable statute and cases, but is not consonant with treasury regulations and practice.

V.

THE ESTATE TAX REGULATIONS WITH REFERENCE TO APPORTIONMENT SUPPORT THE DECISION OF THE COURT OF APPEALS BELOW.

In his brief (Pet. Br. 5, 22, and 23) petitioner refers to an argument made by respondents below in connection with the provisions of Section 81.18 of the Estate Tax Regulations, 105, which, referring to and implementing Section 811 (c), provide in pertinent part as follows:

> "If such retention or reservation is of a part only of the use, possession, income, or other enjoyment of the property, then only a corresponding proportion of the value of the property should be included in determining the value of the gross estate."

Petitioner apparently misunderstands this argument, and assumes that respondents were asking the court below to make an apportionment in accordance with those provisions, and indicates to the court that respondents are thus asking for relief upon an issue not properly before the

court, because the facts necessary to such apportionme
do not appear in the record. This was not the object
the argument at all. Respondents referred, and now ref
to the quoted section of the Regulations for the purpose
indicating that the application of such section leads to p
cisely the results already reached in the courts below. T
facts pertinent to this argument are in the record.

In the instant case the apportionment referred to in t
Regulations has already been made. The apportionme
was specified in the contracts themselves, upon mathema
cal and actuarial principles of general use and acceptati
principles which the petitioner has not and cannot ass
and which would be accepted in any litigation regardi
such question of apportionment. Under this apporti
ment, the annuity payments, together with the dividen
on the annuity policy, include all of the income alloca
to the annuity premium, whereas the dividends on the l
insurance policy, together with the appreciation in val
thereof, constitute the income upon the life insuran
premium. Hence, it is clear that application of Secti
81.18 of the Regulations leads to precisely the res
reached in the courts below, namely, that decedent reserv
no income with reference to the life insurance policy, a
that no portion of the proceeds of such policy are includi
under Section 811 (c)(1)(B).

This argument was made below and is restated here,
well as the argument based upon Section 22 (b)(2) of t
Internal Revenue Code[20] for the purpose also of demo
strating that the position of the petitioner is in confli
with other provisions of the statute and regulations, a
with common practice pertaining thereto.

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20. Discussed at length in the last preceding section of the bri
i. e., Section IV (5).

CONCLUSION.

As applied to the instant case, the meaning of Section 811 (c)(1)(B) is clear. That section was designed to prevent tax avoidance. The instant case falls within neither the letter nor the spirit of its language. The attempt of the petitioner to bring the facts of the instant case within the intendment of that language is neither realistic nor logical. The cases have enunciated a mandate subordinating form to substance and prohibiting consideration of artificial or technical devices of conveyancing with regard to that section. *Helvering* v. *Hallock*, 309 U. S. 106 (1940). Certainly the Supreme Court intended the government as well as the taxpayer to be bound by that same mandate.

It is respectfully requested that the decision of the Court of Appeals be affirmed.

Respectfully submitted,

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APPENDIX.

Internal Revenue Code:

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

* * *

(c) [as amended by Section 7 (a) of the Act of October 25, 1949, c. 720, 63 Stat. 891] *Transfers in Contemplation of, or Taking Effect at, Death*—

(1) *General Rule.*—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

* * *

(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; or

(C) intended to take effect in possession or enjoyment at or after his death.

* * *

(26 U. S. C. 1946, ed., Supp. III, Sec. 811.)